

What is Paradox of Savings?

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About Paradox of Savings:

- The paradox of savings, also known as the **paradox of thrift**, refers to the theory that a **rise in the savings rate of individuals** can surprisingly **cause a fall** rather than a rise **in the overall savings in an economy**.
- This is in contrast to the general belief that a rise in individuals' savings rates will cause a rise in overall savings in the economy.
- So even though savings may be good for an individual household, it is believed that it may not be good for the wider economy.
- The idea is **part of the under-consumption theories** of the business cycle, which **attribute economic downturns to weak consumption and high savings**.
- **Origins of the theory:**
 - The concept was popularized by British economist **John Maynard Keynes** in his 1936 book, *The General Theory of Employment, Interest, and Money*.
 - Keynesian economists believe that **higher savings is bad** for the wider economy, and that **boosting consumer spending** is the **way to grow an economy**.

- They argue that **savings are invested by capitalists** with the ultimate **aim of selling their output** in the form of final goods and services to consumers.
 - So, **if consumers fail to spend** enough money **on the output** that capitalists bring to the market to sell, it **can cause losses for capitalists** and **discourage further investment**.
 - On the other hand, a **rise in consumer demand** for final goods and services is expected to **encourage people to save more and invest**.
 - **Criticisms of the idea:**
 - Critics of the idea argue that saving more is not bad for the economy and that a **fall in consumer spending** does **not actually cause a fall in investment**.
 - In fact, they argue that a fall in consumer spending leads to a rise in savings and investment.
 - This is simply because any **money that people don't spend on consumer goods** or hoard under their beds has to **go towards their savings**, which in turn **gets invested**.
 - An increase in savings **allows banks to lend more**. This will **make interest rates go down** and lead to an increase in lending and, therefore, spending.
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Q1: Who was John Maynard Keynes?

John Maynard Keynes was an early 20th-century British economist, best known as the founder of Keynesian economics and the father of modern macroeconomics. One of the hallmarks of Keynesian economics is the idea that governments should actively try to influence the course of economies, especially by increasing spending to stimulate demand in the face of recession. His most important work, *The General Theory of Employment, Interest and Money* (1935–36), advocated a remedy for economic recession based on a government-sponsored policy of full employment.

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